California Case Underscores Importance of Arbitration Choice-of-Law Provisions

The California Court of Appeal recently upheld the denial of a motion to compel arbitration because the parties' arbitration agreement contained a choice-of-law provision selecting California law without also selecting applicable federal law – specifically, the Federal Arbitration Act (FAA). In the same case, however, the court required arbitration of claims against a different defendant because that defendant's agreement contained a Nebraska choice-of-law provision. Particularly for companies that face consumer litigation potentially involving multiple defendants, the case illustrates the importance of drafting choice-of-law provisions with arbitration in mind.

Three Defendants, Two Arbitration Agreements

Mastick v. TD Ameritrade, Inc. involved three defendants: an accountant, an investment management company (Oakwood), and a broker-dealer (TD Ameritrade). Two of the three defendants moved to compel arbitration of the plaintiff's claims – Oakwood with the American Arbitration Association (AAA) and TD Ameritrade with the Financial Industry Regulatory Authority (FINRA) – and to stay plaintiff's action. The plaintiff had no arbitration agreement with the accountant, but she had agreed to arbitrate any disputes with Oakwood before the AAA and any with TD Ameritrade before FINRA. Plaintiff's agreements with Oakwood stated that the parties would be governed by California law, and her agreements with TD Ameritrade provided that the parties would be governed by Nebraska law.

California Lawn Denies Arbitration If There Is A Risk Of Conflicting Results

Unlike the FAA, the California Arbitration Act (CAA) expressly permits courts to deny a petition to compel arbitration under certain circumstances where related litigation or other proceedings create a risk of conflicting rulings. When Oakwood sought to compel arbitration before the AAA, the trial court denied the motion, finding that the CAA (rather than the FAA) applied, and that inconsistent rulings might occur if separate litigation and arbitration actions proceeded in connection with the same transaction. The court also denied TD Ameritrade's motion on the same grounds.

No Federal Preemption Where The Parties Agree That State Law Applies

On appeal, the Court of Appeal affirmed in part and reversed in part. It concluded that the FAA does not preempt application of the CAA to an arbitration agreement where the parties have expressly agreed to be governed by California law – like the Oakwood agreement. On the other hand, where the agreement does not include a California choice-of-law provision – like the TD Ameritrade agreement – the FAA must be applied to require arbitration of the parties' dispute.

The court acknowledged that the lower court's decision was "reasonable, fair, and consistent with common sense," yet was unsupported by the law. According to the court (and undisputed by plaintiff), the FAA governs arbitration provisions in contracts that involve interstate commerce, including plaintiff's agreements with both Oakwood and TD Ameritrade. When the FAA applies, it preempts any contrary state law and is binding on both state and federal courts, requiring courts to enforce arbitration provisions. Further, the FAA does not authorize courts to stay arbitration pending resolution of litigation or to refuse to enforce a valid arbitration provision to avoid duplicative proceedings or conflicting rulings.

The court stated, however, that parties to a contract may agree that the FAA will not apply to the arbitration of disputes between them, even if their agreement involves interstate commerce. And if the parties have agreed that California law governs the contract, without any reference to the FAA, the court found that the CAA applies. The court held that when parties have agreed to be governed by California law, with no reference to the FAA, the CAA does not conflict with the FAA or frustrate its objectives, and the courts must enforce the arbitration provisions in accordance with the terms of the parties' agreement, with the result that the FAA will not be found to preempt the CAA.

The Court of Appeal affirmed the lower court's ruling that under the Oakwood agreement, the CAA applied, and found that the lower court did not err in denying the defendant's petition to compel arbitration. The court found that authorities did not support Oakwood's contention that a general California choice-of-law provision should not invoke the specific provisions of the CAA, particularly when the parties agreed that arbitration would proceed under AAA arbitration rules. The Court of Appeal also found that the lower court did not abuse its discretion when it found that enforcement of the agreements to arbitrate claims against Oakwood would create a risk of conflicting rulings, finding that plaintiff's claims against the defendants were based on a single injury arising from advice given at a single meeting concerning a single transaction.

Under Nebraska Law, Arbitration Required Even If Conflicting Rulings Might Result

In contrast, plaintiff's agreements with TD Ameritrade did not contain a California choice-of-law provision, but rather provided that the agreements would "be governed by the laws of the State of Nebraska," and that disputes would be resolved by arbitration "in accordance with the rules of FINRA." Like the FAA – and unlike the CAA – Nebraska's Uniform Arbitration Act does not authorize a court to stay arbitration or refuse to enforce an arbitration provision in order to avoid duplicative proceedings or conflicting rulings.

Under Nebraska law, the courts must stay any issues that are subject to arbitration until such arbitration is concluded. This required that plaintiff's lawsuit against TD Ameritrade be stayed pending the conclusion of arbitration between the parties.

In light of *Mastick*, companies that use arbitration provisions and do business in California should consider their choice-of-law provisions and determine whether these provisions expressly reference federal law and the FAA, at least with respect to arbitration issues. In addition, *Mastick* is yet another example of a court denying an arbitration motion based on contract language outside the arbitration provision itself. In order to maximize the prospects for enforcing an arbitration clause, companies should review their entire agreement, not just the arbitration provisions.

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